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Arizona Corporation Commission

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Commissioner

DEC 15 2011

BRENDA BURNS
Commissioner

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IN THE MATTER OF THE APPLICATION)
OF ARIZONA-AMERICAN WATER)
COMPANY, AN ARIZONA)
CORPORATION, FOR A)
DETERMINATION OF THE CURRENT)
FAIR VALUE OF ITS UTILITY PLANT)
AND PROPERTY AND FOR INCREASES)
IN ITS RATES AND CHARGES BASED)
THEREON FOR UTILITY SERVICE BY ITS)
AGUA FRIA WATER DISTRICT, HAVASU)
WATER DISTRICT, AND MOHAVE)
WATER DISTRICT.)

DOCKET NO. W-01303A-10-0448

NOTICE OF FILING
TESTIMONY IN SUPPORT OF
SETTLEMENT

Attached is Testimony in Support of Settlement of Paul G. Townsley and Thomas
M. Broderick filed on behalf of Arizona-American Water Company.

RESPECTFULLY SUBMITTED this 15th day of December, 2011.

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Company

ORIGINAL and thirteen (13) copies
of the foregoing filed
this 15th day of December, 2011, with:

1 The Arizona Corporation Commission
2 Utilities Division – Docket Control
3 1200 W. Washington Street
4 Phoenix, Arizona 85007

5 Copy of the foregoing hand-delivered
6 this 15th day of December, 2011, to:

7 Steve Olea
8 Utilities Division
9 Arizona Corporation Commission
10 1200 W. Washington Street
11 Phoenix, Arizona 85007

12 Dwight D. Nodes, Administrative Law Judge
13 Arizona Corporation Commission
14 1200 W. Washington Street
15 Phoenix, Arizona 85007

16 Janice Alward, Chief Counsel
17 Charles Hains
18 Legal Department
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21 Phoenix, Arizona 85007

22 Copy of the foregoing mailed
23 this 15th day of December, 2011, to:

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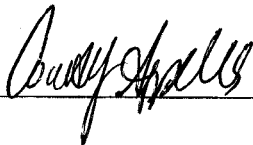
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
PAUL NEWMAN
SANDRA D. KENNEDY
BRENDA. BURNS

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS AGUA FRIA
WATER, HAVASU WATER AND MOHAVE
WATER DISTRICTS

DOCKET NO. W-01303A-10-0448

**TESTIMONY OF PAUL G. TOWNSLEY
IN SUPPORT OF SETTLEMENT AGREEMENT
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
DECEMBER 15, 2011**

**TESTIMONY OF PAUL G. TOWNSLEY
IN SUPPORT OF SETTLEMENT AGREEMENT
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
DECEMBER 15, 2011**

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EXECUTIVE SUMMARY

Paul G. Townsley testifies that:

The Settlement Agreement is a fair and reasonable resolution of this highly contested rate proceeding. It mitigates rate shock while still recognizing in rate base the prudent investment in the White Tank Water Treatment Plant. The settlement process was open and inclusive and the result benefits all parties.

I INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND TITLE.

A. My name is Paul G. Townsley. My business address is 2355 North Pinnacle Peak Road, Suite 300, Phoenix, AZ 85027. I am the president of Arizona-American Water Company ("AAWC").

**Q. ARE YOU THE SAME PAUL G. TOWNSLEY WHO PREVIOUSLY
SUBMITTED TESTIMONY IN THIS CASE?**

A. Yes.

II PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will provide testimony in support of the proposed Settlement Agreement. I will discuss the settlement process, the settlement terms and the settlement benefits.

III SETTLEMENT PROCESS

**Q. PLEASE PROVIDE A BRIEF SUMMARY OF THE PROCEEDINGS LEADING
UP TO SETTLEMENT.**

A. On November 13, 2010, AAWC filed with the Commission an Application for a rate increase for the Agua Fria, Mohave and Havasu Water Districts. In its application AAWC requested revenue increase of \$20.8 million. There were seven (7) rounds of testimony filed by numerous parties. AAWC responded to hundreds of data requests. In addition to open houses sponsored by AAWC, the Arizona Corporation Commission ("Commission") also held public comment sessions. The hearing on this matter commenced on December 5, 2011, but did not conclude.

1 In January 2011, after the rate application was filed, American Water Works Company
2 announced that it had reached an agreement to sell all of the outstanding stock of AWWC
3 to EPCOR, Water (USA), Inc. ("EPCOR"). That transaction was approved by the
4 Commission on November 17, 2011, in Docket No. W-01303A-11-0101, Decision No.
5 72668. That sale has not closed yet. EPCOR intervened in the rate case proceeding on
6 August 24, 2011.

7 **Q. PLEASE DESCRIBE THE SETTLEMENT PROCESS.**

8 A. Once the Commission approved the sale of AAWC to EPCOR, EPCOR initiated
9 discussions about the possibility of settlement. A formal settlement conference was
10 noticed and held at the offices of the Residential Utility Consumer Office ("RUCO") on
11 December 6, 2011. All the parties were invited to this conference and all of the parties
12 who participated in the hearing on December 5, 2011, attended the December 6
13 settlement conference.

14 **Q. PLEASE DESCRIBE THE NEGOTIATIONS THAT RESULTED IN THE**
15 **SETTLEMENT AGREEMENT?**

16 A. The settlement agreement is the product of candid discussions among the parties. All
17 participants had an opportunity to meaningfully participate throughout the negotiations.
18 The participants were able to express their positions fully. These talks produced a well-
19 balanced and fair result that illustrates a willingness of the parties to find common ground
20 and to reach a compromise position that provides benefits for all parties.

21 **Q. WHAT HAPPENED AS A RESULT OF THE DECEMBER 6 SETTLEMENT**
22 **CONFERENCE?**

23 A. The parties entered into a Letter of Intent on December 8, 2011, which was filed with the
24 Commission on December 9, 2011. This Letter of Intent served as the basis for the

Settlement Agreement, a copy of which is being filed separately in the docket and which I will support at the hearing.

IV. SETTLEMENT TERMS

Q. PLEASE DESCRIBE THE MAJOR TERMS OF THE SETTLEMENT.

A. The following terms are applicable to all three of the water districts in this case.

1. New rates shall become effective on July 1, 2012.
2. The approved return on equity shall be 10.6%, and the authorized rate of return shall be 7.1%.
3. The capital structure shall be long-term debt, 47.38%; short-term debt, 11.35%; equity, 41.27%.
4. The cost of long-term debt is 5.66% and the cost of short-term debt is 0.41%.
5. The settling parties accepted Staff's proposed depreciation rates.
6. All parties agreed to support and defend the settlement and to take any and all steps reasonably necessary to obtain Commission adoption of the material terms of the Settlement Agreement.

Q. WHAT ARE THE MATERIAL ASPECTS OF THE SETTLEMENT UNIQUE TO THE AGUA FRIA WATER DISTRICT?

A. The following terms are applicable to the Agua Fria Water District.

1. All of the White Tanks Plant and White Tank Plant related deferrals shall be included in rate base as proposed by AAWC.
2. AAWC shall be authorized a 58% overall revenue increase phased in (the "Phase In") over three years in twelve-month increments as follows:

Period ¹	Percentage Increase	Revenue Increase ²
July 1, 2012 to June 30, 2013	39%	\$9,437,026
July 1, 2013 to June 30, 2014	9.5%	\$11,735,788
July 1, 2014 to June 30, 2015	9.5%	\$14,034,551

¹ This assumes an effective date of new rates of July 1, 2012 and will be adjusted accordingly.

² The figures represent the total annual revenue increase to-date.

3. AAWC agrees to forego authorized revenue and carrying costs during the term of the Phase In as set forth above. These foregone revenues will be almost \$6.9 million.
4. AAWC's next rate case filing shall use a test year including at least six months of actual experience with the final phase of rates.
5. Upon approval of new rates in this rate case, and until new rates are approved in AAWC's next rate case for the Agua Fria Water District, AAWC will credit back to customers the revenue requirement equivalent of non-refundable hook-up fees actually collected under AAWC's White Tanks HUF Tariff Part B in the prior 12 months commencing in Year 2 of the Phase In. This credit will be shown as a special line item on customer bills. AAWC will work with Staff on a plan of administration for timely provision of these credits to customers.
6. Upon approval of new rates in this rate case, and until new rates are approved in AAWC's next rate case for the Agua Fria Water District, AAWC will credit back to customers any sales of the White Tanks Plant's non-firm treatment services. For Year 2 of the Phase In, AAWC will credit back to customers any sales of non-firm treatment services in the prior 18 months using a formula to be agreed by the parties (i.e. incremental revenues from sales minus expenses in excess of amounts in rates). In Year 3 of the Phase In, AAWC will credit back to customers any sales of non-firm treatment services accruing in the prior 12 months using the same formula. This credit will also be shown separately with the HUF-related credit. AAWC will work with Staff on a plan of administration for these credits.
7. The non-potable irrigation rate for the Corte Bella Golf Club shall be \$.92 per 1000 gallons.

Q. WHAT ARE THE MATERIAL TERMS UNIQUE TO THE MOHAVE WATER DISTRICT?

A. The following terms are applicable to the Mohave Water District.

1. AAWC shall be authorized a revenue increase of \$1,812,486.
2. AAWC agrees to develop a five year plan to reduce non-revenue water in the Mohave District. The plan shall be based on leak survey and system analysis performed by AAWC to determine the most cost effective approach to reducing water loss. Such plan shall be filed by AAWC in this docket by March 1, 2013.
3. AAWC accepts Staff's adjustment GWB-13 relating to excess water loss.

Q. WHAT ARE THE MATERIAL TERMS OF THE SETTLEMENT AGREEMENT APPLICABLE TO THE HAVASU WATER DISTRICT?

A. The following terms are applicable to the Havasu Water District:

1. AAWC shall be authorized a revenue increase of \$609,838.
2. AAWC agrees to develop a five year plan to reduce non-revenue water in the Havasu District. The plan shall be based on leak survey and system analysis performed by AAWC to determine the most cost effective approach to reducing water loss. Such plan shall be filed by AAWC in this docket by March 1, 2013.
3. AAWC accepts Staff's adjustment GWB-13 relating to excess water loss.

V SETTLEMENT BENEFITS

Q. WHAT ARE THE BENEFITS OF THE SETTLEMENT?

A. This settlement minimizes rate shock to customers in the Agua Fria District by adopting a reduction in the requested rate increase together with a phase-in of the rate increase.

AAWC also agrees to forgo authorized revenue and carrying costs during the term of the phase-in.

The settlement contains the potential for future rate reductions based on the payment of hookup fees for the White Tanks Plant and the sale of non-firm water treatment services.

The settlement promotes sustainability by placing into rate base the costs associated with the White Tanks Plant. This plant saves 3 billion gallons of ground water annually and is an important implementation of Arizona state and regional policy as articulated by WESTCAPS, the Governor's Blue Ribbon Panel and the Arizona Department of Water Resources.

The settlement reduces rates to customers by adopting Staff's proposed return on equity of 10.6%, rather than AAWC's requested rate of 11.5%.

The settlement adopts an updated capital structure reflecting the reduction of short-term debt and increased equity of AAWC as directed in prior Commission orders.

The settlement effectively postpones the next rate increase filing for the Agua Fria District until at least 2016.

1 The settlement contains a provision to address non-revenue water in the Mohave and
2 Havasu districts including requiring AAWC to conduct a system analysis and to develop
3 a five (5) year plan to reduce non-revenue water to be reviewed by Staff.

4 The settlement includes a low-income tariff for all three districts to benefit those users
5 who are most financially vulnerable. Similar to the recently adopted low income tariff in
6 the Sun City District, this tariff provides discounts to qualifying residential customers on
7 the monthly minimum charge. In addition, AAWC will work through the Arizona
8 Community Action Alliance to provide this discount to residents.

9 The settlement helps stabilize AAWC's fragile financial condition by providing an
10 opportunity to earn a positive rate of return of 7.1%.

11 **Q. WHY DID COMPANY AGREE TO SETTLE FOR LESS THAN IT REQUESTED.**

12 A. AAWC agreed to some material reductions in its rate request. For instance, rather than
13 have a revenue increase of \$20.8 million as requested, it will receive a revenue increase
14 of about \$11.1 million in year one, \$14.1 million in year two and then \$16.4 million in
15 year three. Its authorized return on equity will be 10.6% rather than 11.5%. Short-term
16 debt will be included in capital structure, thereby reducing the equity percentage
17 proposed by AAWC. On the other hand, AAWC avoids the expense and uncertainty of
18 protracted litigation, including potential appeals. The settlement is responsive to our
19 customers' concern about rate shock. The settlement allows AAWC to include in rate
20 base its investment in the White Tanks Plant. In sum, the Settlement Agreement finds
21 middle ground between the disputing parties.

1 **Q. DO YOU BELIEVE THE COMMISSION'S ADOPTION OF THIS PROPOSED**
2 **SETTLEMENT AGREEMENT STRIKES A FAIR BALANCE OF INTERESTS**
3 **BETWEEN AAWC AND THE RATE PAYERS?**

4 A. Yes, under the circumstances of the instant case, I believe that the proposed Settlement
5 Agreements effects a fair balance between the interests of AAWC's shareholders and its
6 ratepayers.

7 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

8 A. Yes.

1 BEFORE THE ARIZONA CORPORATION COMMISSION

2 COMMISSIONERS

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5 GARY PIERCE, Chairman
6 BOB STUMP
7 PAUL NEWMAN
8 SANDRA D. KENNEDY
9 BRENDA BURNS

10 IN THE MATTER OF THE APPLICATION OF
11 ARIZONA-AMERICAN WATER COMPANY,
12 AN ARIZONA CORPORATION, FOR A
13 DETERMINATION OF THE CURRENT FAIR
14 VALUE OF ITS UTILITY PLANT AND
15 PROPERTY AND FOR INCREASES IN ITS
16 RATES AND CHARGES BASED THEREON
17 FOR UTILITY SERVICE BY ITS AGUA FRIA,
18 HAVASU AND MOHAVE WATER DISTRICTS

DOCKET NO. W-01303A-10-0448

19 **TESTIMONY OF THOMAS M. BRODERICK**
20 **IN SUPPORT OF SETTLEMENT AGREEMENT**
21 **ON BEHALF OF**
22 **ARIZONA-AMERICAN WATER COMPANY**
23 **DECEMBER 15, 2011**
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**TESTIMONY OF THOMAS M. BRODERICK
IN SUPPORT OF SETTLEMENT AGREEMENT
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
DECEMBER 15, 2011**

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I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Thomas M. Broderick. My business address is 2355 North Pinnacle Peak Road, Suite 300, Phoenix, AZ 85027.

Q. ARE YOU THE SAME THOMAS M. BRODERICK WHO PREVIOUSLY SUBMITTED TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. To support the Settlement Schedules attached to the parties' Settlement Agreement. My testimony will also address the provisions of the Settlement Agreement relating to credits to customers for non-refundable hook up fees. Finally, my testimony will also address the Company's proposed low income tariff.

II. THE SETTLEMENT SCHEDULES

Q. PLEASE DESCRIBE THE SETTLEMENT SCHEDULES ATTACHED AS EXHIBIT C TO THE SETTLEMENT AGREEMENT.

A. The Settlement Schedules are the result of an effort that began during the settlement discussions with Staff and RUCO to translate the Settlement Agreement into final schedules. Each of us had our own working set of complete schedules, so a common template needed to be selected. Staff's template for the Schedules A – F was relied upon to update into a final form. The Company's Schedule H was relied upon to update and conform into a final form. The Parties circulated the Schedules, reviewed them and provided comments.

III. CUSTOMER CREDITS

Q. HAS THE COMPANY PROVIDED A FORMULA FOR FUTURE USE IN CALCULATING REVENUE CREDITS ASSOCIATED WITH WHITE TANKS HOOK-UP FEES ONCE THOSE FEES ARE ACTUALLY KNOWN FOR THE FUTURE MEASUREMENT PERIODS AS DESCRIBED IN THE SETTLEMENT AGREEMENT?

A. Yes. The Company has provided a spreadsheet that will later be populated with actual data as time passes. For now, illustrative data has been inserted. For example, if actual White Tanks hook-up fees are \$1 million in the first year, then the revenue credit to customers will be \$124,151 in the second year. The spreadsheet presently runs through 2018, but it can be shortened or lengthened depending on the actual period of time until rates in the next rate case are effective. This feature of the Settlement Agreement is clearly beneficial to customers as it is a non-traditional ratemaking feature not available in a litigated case.

IV. LOW INCOME TARIFFS

Q. DOES THE SETTLEMENT AGREEMENT INCLUDE A LOW INCOME PROGRAM AND TARIFF FOR THE AGUA FRIA, HAVASU, AND MOHAVE WATER DISTRICTS FOR COMMISSION APPROVAL IN COMPLIANCE WITH DECISION NO. 72630?

A. Yes. The proposed program and tariff are attached as Exhibit A to the Settlement Agreement. The program itself is the same as I described in my August 9, 2011 Rejoinder Testimony (Page 1, Line 10 through Page 3, Line 20) which also complies with Decision No. 72630. The tariffs have now been updated based on the settled rate design.

Q. HOW WILL THE PROGRAM BE ADMINISTERED?

A. The Company has come to terms on a proposed agreement with the Arizona Community Action Association ("AZCAA"), which administers existing low income programs for several utilities including APS. If the Commission grants approval of the low income program, the Company and AZCAA will proceed with signing the agreement and shortly thereafter the low income program will commence in Agua Fria, Havasu and Mohave. AZCAA, as the umbrella administrator, will work with specific separate field program administrators that will actually issue the low income credits. AZCAA's fee is 10% of the credits issued and the field program administrators also charge 10%. Therefore, the administrative program cost is 20% of the actual credits issued. The Company does not plan to account for any of its internal program costs as part of the program costs.

Q. IS THE PROGRAM MODELED ON THE REVISED LOW INCOME PROGRAM NOW IN EFFECT IN THE COMPANY'S SUN CITY WATER DISTRICT?

A. Yes, it is essentially identical and like Sun City it will have a true-up feature such that the Company neither incurs a financial benefit or loss from the program. The net balance of collections less credits and contractor expenses will be tracked monthly as a regulatory asset or liability on the Company's books.

Q. WHAT ARE THE SPECIFICS OF THE LOW INCOME PROGRAM FOR THE AGUA FRIA DISTRICT?

A. The Company proposes that up to 1,000 Agua Fria residential customers on 5/8 and 3/4 inch meters participate in the program if they meet the same low income criteria as established for the Sun City program. The Company proposes a monthly credit of \$7.50 for participants for a total annual credit of \$90,000. Adding the 20% administrative cost

brings the total annual cost to \$108,000. As with Sun City, the Company proposes to increase the high block commodity rate for all residential and commercial customers in Agua Fria by \$0.08462 per 1,000 gallons in order to fund the program.

Q. WHAT ARE THE SPECIFICS OF THE LOW INCOME PROGRAM FOR THE HAVASU DISTRICT?

A. The Company proposes that up to 100 Havasu residential customers on 5/8 and 3/4 inch meters participate in the program if they meet the same criteria. The Company proposes a monthly credit of \$10.00 for participants for a total annual credit of \$12,000. Adding the 20% administrative cost brings the total annual cost to \$14,400. The Company proposes to increase the high block commodity rate for all residential and commercial customers in Havasu by \$0.15192 per 1,000 gallons to fund the program.

Q. WHAT ARE THE SPECIFICS OF THE LOW INCOME PROGRAM FOR THE MOHAVE DISTRICT?

A. The Company proposes that up to 1,000 Mohave residential customers on 5/8 and 3/4 inch meters participate in the program if they meet the same criteria. The Company proposes a monthly credit of \$5.00 for participants for a total annual credit of \$60,000. Adding the 20% administrative cost brings the total annual cost to \$72,000. The Company proposes to increase the high block commodity rate for all residential and commercial customers in Agua Fria by \$0.2099 per 1,000 gallons to fund the program.

Q. IS THIS LOW INCOME PROPOSAL IN COMPLIANCE WITH DECISION NO. 72630?

A. Yes.

1
2 **Q. HAVE THE HIGH BLOCKS OF THE AFFECTED RATES IN THE H**
3 **SCHEDULES BEEN INCREASED FOR THE LOW INCOME PROGRAMS?**

4 A. No, but the amounts are stated within the H Schedules in the form of a rider to the tariffs.

5 **Q. DOES THIS CONCLUDE YOUR TESTIMONY IN SUPPORT OF THE**
6 **SETTLEMENT AGREEMENT?**

7 A. Yes.
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